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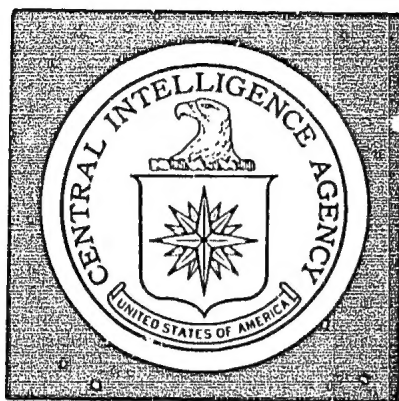
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Intelligence Memorandum

The Economic Situation In Cambodia

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March 1971

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CENTRAL INTELLIGENCE AGENCY
Directorate of Intelligence
March 1971

INTELLIGENCE MEMORANDUM

The Economic Situation In Cambodia

Highlights

1. In the past two months, the impact of the war on the Cambodian economy has become severe, as continued disruptions to transportation have greatly restricted imports, exports, and the internal distribution of goods. With pre-war stocks generally depleted and with military spending rapidly pushing up the money supply, inflation has greatly accelerated and confidence in the currency has plummeted. There is no doubt that the standard of living of most Cambodians has been reduced, as urban workers suffer from unemployment and shortages of consumer goods while farmers are in a cost-price squeeze. Supplies of basic necessities, including rice, remain sufficient, however, so that the economy's problems do not appear to threaten the population's health or well-being.

2. The long-awaited 1971 budget was approved by the cabinet on 19 March. Budgeted expenditures total 18.7 billion riels (about \$337 million), 62% of which are allocated for the Ministry of Defense. The projected deficit of 6.0 billion riels is about 35% below last year's in anticipation of increased receipts from higher taxes and increased customs revenues generated by the US aid program.

3. The price index for working class families in Phnom Penh increased 18% during January, compared with only 27% during the entire preceding year. Inflationary pressure eased considerably

Note: This memorandum was prepared by the Office of Economic Research.

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after mid-February, however, with the reopening of road and railroad bridges, the destruction of which had greatly slowed the flow of meats and foodstuffs from Battambang Province for nearly six weeks.

4. After being relatively stable for several months at a rate of about 90 riels per US \$1 -- compared with an official rate of 55.5 riels per US \$1 -- the black market rate in Phnom Penh had declined to 130 riels per US \$1 by 18 March. The Hong Kong rate was even lower, as rumors of an impending devaluation and the worsening economic situation resulted in large transfers of capital from the country.

5. By early March the rice harvest in Battambang Province was about 90% completed. The crop was bountiful, but farmers' earnings have been sharply squeezed by rising labor costs and low prices offered by buyers, whose warehouses are already overflowing because of transport disruptions. There have been no shipments of rice by rail to Bangkok for export, despite an intergovernmental agreement and secure conditions, and the Thais appear to have taken over a large part of the rice market in Senegal, Cambodia's principal customer in recent years.

6. Continued insecurity along Route 4 has forced the diversion of maritime shipping from Kompong Som to Phnom Penh. Petroleum shipments are arriving in Phnom Penh with regularity and in sufficient quantities to cover current needs. The destruction of storage facilities at the Kompong Som refinery will keep it out of operation for at least several months, but this will not affect the shipment of petroleum up the Mekong from South Vietnamese facilities. Shipping on the Mekong, however, continues to be threatened by enemy gunfire and mines, which have held down the volume and raised the cost of imports.

7. Charts on prices and currency outstanding; imports, exports, and foreign exchange revenues; and government borrowing from the Banque du Cambodge follow the text.

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The 1971 Budget

8. After much delay in compiling and evaluating wartime requirements of the various ministries, a revised draft budget for the current year was finally approved by the Cabinet on 19 March and now goes to the National Assembly, where it is expected to be passed without change.* Costs incident to the war and mobilization have boosted proposed expenditures to 18.7 billion riels (\$337 million**), compared to actual expenditures of 13.8 billion riels in 1970 and only 8.4 billion riels in 1969. On a monthly basis, 1971 expenditures are expected to average 30% above the rate during the fourth quarter of 1970. The Ministry of Defense is allocated 11.5 billion riels, or 62% of total expenditures.

9. Receipts are estimated at 12.7 billion riels (\$229 million), the bulk of which -- 5.8 million riels -- represents US counterpart funds. Excise taxes and customs duties are expected to account for 2.2 billion riels in revenue, general taxes for 3.1 billion riels, and miscellaneous receipts for the balance.

10. The new budget incorporates several Cabinet revisions made on recommendation of the Finance Ministry. The principal change is a reduction of 1 billion riels in proposed defense appropriations. Of the 11.5 billion riels finally approved for the Ministry of Defense, only 1 billion riels is allocated to materiel expenditures, about 500 million riels less than originally proposed, but the military has made it clear that their acceptance of the cut is conditional upon substantial MAP deliveries. The Cabinet also approved rate increases of up to 50% for many existing taxes, thereby adding 1.3 billion riels to expected revenues.

11. The changes trimmed the expected budget deficit to 6.0 billion riels from the nearly 8.7 billion riels originally projected, but there appears to be ample scope for further cuts in

* *The Cambodian fiscal year corresponds to the calendar year.*

** *At the official rate of 55.5 riels per US \$1.*

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appropriations for activities not related to the war. The civilian budget for example, has been increased by 7% over last year's -- to 7.2 billion riels -- although the government's loss of control over substantial portions of the population and territory would seem to justify reduced appropriations. Education, for example, is allocated over 30% of nonmilitary expenditures, despite the fact that many schools have been closed and large numbers of teachers and students have entered the army. In addition, the allocation of 271 million riels to 17 recently formed "commisariats" appears to duplicate ministerial allocations.

12. There are indications, however, that budgetary considerations have compelled the government to take a more realistic view of sustainable military force levels. [REDACTED]

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a 210,000-man ceiling was in effect for March, despite the fact that 218,000 were on the payroll in mid-February. The new ceiling apparently reflects a significant scaling down of mobilization goals set by the general staff, since ground force units authorized by mid-January would at full strength total more than 300,000.

Monetary Developments

Money Supply

13. War financing continues to result in a large monthly infusion of riels into the economy. Net advances to the state from the Banque Nationale du Cambodge amounted to 937 million riels for December, bringing cumulative government borrowing for all of 1970 to 6.5 billion riels. Net government borrowing, however, dropped to only 625 million riels in January, perhaps as a result of delays in payment of military wages. Currency in circulation reached 11.6 billion riels by the end of 1970, an increase since March of 78%, compared with an increase of 2% for all of 1969. By the end of February, currency in circulation had reached about 13 billion riels, representing an increase of 12% for the first two months of 1971.

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Prices

14. Retail prices in Phnom Penh rose drastically in January. Most of the increase was attributable to a sharp reduction in deliveries of meats and foodstuffs from Battambang following the interdiction of both Route 5 and the rail line from Battambang to Pursat. Both were reopened in mid-February, after being out of service for five or six weeks. The price index for working class families showed an 18% increase for the month, compared with a 27% increase for all of 1970. Reports indicate that increases in the prices of all meats accounted for most of the rise. While government rice stocks are more than adequate to maintain rice prices at present levels and speculative buying is not apparent in the case of any commodity, sustained declines in supplies of important items will certainly trigger even greater increases in price levels.

Black Market Currency Prices

15. The black market value of the riel showed a steady deterioration during February and March. After being relatively stabilized at about 90 riels per US \$1 for several months, a further decline began in February and was accelerated by the announcement on 11 March that goods to be imported under the first \$10-million portion of the US economic aid program would carry a 50% "war tax," thus pegging the effective exchange rate for these commodities at 83 riels per US \$1.* The black market price of US dollars in Phnom Penh had reached 130 riels per US \$1 by 18 March. (The official rate is 55.5 riels per US \$1.)

16. The value of the riel has been consistently lower on the Hong Kong market, reaching a record low of 150 riels per US \$1 on 19 March. The sharp depreciation in the riel's value is attributable largely to transfers of capital out of Cambodia in anticipation of a devaluation. Rumors of an

* Last May, when VC/NVA forces were rapidly extending their control over large sections of the country, the value of the riel reached its 1970 low, but its value never dropped below 130 riels per US \$1.

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across-the-board devaluation have been circulating in Phnom Penh for some time, and an IMF team of experts due in Phnom Penh in late March to discuss possible fiscal reforms is expected to push for such a move.

Counterfeit Riels

17. A recent announcement by the Banque Nationale du Cambodge accuses the VC/NVA of plotting to destroy the Khmer economy by circulating counterfeit bills and warns the public against acceptance of the fraudulent notes. The notes reportedly are convincing facsimiles of the 500-riel note first issued at the end of February 1970.

18. Although recent arrests and seizures of large quantities of the bogus notes in Battambang point to a Thai-based operation, firm evidence is lacking regarding its location or whether or not it is Communist-organized. There are also sharply conflicting reports as to the amounts of money involved. There is no question, however, that a serious counterfeiting problem exists, and Cambodian authorities are gravely concerned. [REDACTED]

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[REDACTED] there is already considerable panic among market vendors and shopowners in Phnom Penh, some of whom are refusing to accept any 500-riel notes.

19. Just one year ago, widespread Communist use of counterfeit bills (which also first appeared in Battambang) forced the Cambodian government to recall all 500-riel notes in exchange for a new issue that was supposedly extremely difficult to counterfeit. By stipulating that after 7 March 1970 the old 500-riel note would have no value and that a limit of 10,000 riels per person could be exchanged, the government hoped to leave the Communists holding an empty bag. [REDACTED]

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[REDACTED] the Communists had moved quickly to rid themselves of the counterfeits, successfully bilking many Cambodian peasants in the process. The government, if possible, wants to avoid recalling the current issue, since such an action, especially at the present time, might further weaken confidence in the currency.

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US Economic Aid

20. A US-Cambodian agreement signed on 2 March provides for \$10 million in grant aid under which the United States would reimburse Cambodia for certain urgently needed commercial imports financed with its own foreign exchange. The agreement represents the first commitment of funds from the \$70-million FY 1971 supplemental economic aid package authorized by the US Congress in January. A second agreement, signed the same day, provides for \$8.5 million in agricultural commodities to be supplied under Public Law 480.

21. The FY 1971 aid program requires proceeds from the resale of US commodities by Cambodia to be deposited in a special counterpart fund. The riels to be deposited will be calculated at an effective exchange rate of 83 riels to US \$1 -- the official rate, which remains at 55.5 riels to the dollar, plus a 50% "exchange tax." The exchange tax, which did not require National Assembly approval, is understood to be only a temporary solution to the problem, since both the IMF and the US government would prefer a unitary exchange rate.

22. An IMF mission was due in Phnom Penh at the end of March to push for adoption of certain austerity measures designed to stave off further deterioration of Cambodia's financial position. Discussions will probably center on such measures as increasing customs duties and turnover taxes, initiating 100% advance riel deposits against foreign exchange purchases, increasing interest rates on time deposits, and adopting a flexible exchange rate. Cambodia has so far resisted external pressure for far-reaching reforms, especially devaluation, expressing the fear that a change in the official exchange rate would aggravate price increases and lead specifically to pressures for military and civilian salary increases. Nevertheless, Cambodian acceptance of the rate of 83 riels to US \$1 for US aid imports is seen as a useful first step in facilitating acceptance of IMF exchange recommendations.

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23. Although an agreement was signed on 27 March for a second \$10-million tranche, on the same reimbursable basis as the first tranche, formal agreement on the remaining \$50 million CIP will await the outcome of IMF discussions.

The Rice Situation

Harvesting Problems

24. Battambang farmers continued to experience great difficulty during February with their rice harvest. Rain and, in some areas, Communist harassment slowed the work, but by far the most serious bottleneck was a severe shortage of labor. The assignment of troops to the Battambang governor to help bring in the crop and the suspension of FANK recruitment in the province during the harvest season did not offset the absence of migrant workers whose normal influx was deterred by insecurity and increased transport costs.* Even the larger co-operatives had difficulty hiring workers, despite substantial wage increases. Field hands who would normally receive 30 riels per day were receiving upwards of 45 riels per day. Farmers who could not afford to pay the high wages were forced to offer a substantial portion -- in some instances as much as 60% -- of their harvest as pay. This form of sharecropping began in early January in Svay Don Keo, Rieng Kessei, and Thmar Kaul districts but by early February was common throughout the province.

25. Although harvesting in the northern parts of the province was reportedly 80% to 90% complete by the end of February, it was far behind schedule in many areas. Official crop estimates will not be available for several months. Millers in Battambang now believe that the crop was even better than last year's, but labor shortages and insecurity in southern Battambang may hold the harvest to a lesser volume.

* *The troops proved unwilling workers, and some petitioned the governor for back pay, claiming their wages were three months in arrears. This has been a common complaint among the military in Cambodia, even in Sihanouk's time.*

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Transport and Marketing

26. The transport of rice from Battambang to Phnom Penh was all but suspended during most of January and early February, when only three or four trucks a day were making the trip.* Deliveries were retarded by the destruction in early January of rail and highway bridges between Battambang and Pursat. Trucks traveling from Battambang on Route 5 could proceed only as far as the destroyed bridge near Svay Don Keo, where rice was ferried across the stream in small boats, then reloaded onto trucks waiting on the opposite bank. Boat owners charging 45 riels per bag profited handsomely from their new-found enterprise and pushed transport costs to Phnom Penh up to 150 riels per bag.** However, the highway and railway bridges were reopened to traffic on 10 and 19 February, respectively, and by the end of the month, traffic from Battambang was moving freely, with 800 tons of rice reaching Phnom Penh daily, but still far below normal delivery rates.

27. The resumption of rice deliveries to the capital helped ease an acute storage problem in Battambang, but most millers and merchants abstained from purchasing rice because of the large stocks on hand and uncertain prospects. The few who bought took only what they could process and ship immediately. The three state enterprises involved in rice-purchasing -- SORAPA, SATRAR, and EAMB -- which were supposedly responsible for supporting the price of paddy, were already well-stocked and short of funds. For example, SORAPA, which functions as the buyer for SONEIXIM, was offering 140 riels per picul (68 kilograms) of paddy, well below government-established prices of between 165 and 180 riels per picul. Reportedly, few farmers were accepting the offer. SORAPA is reported to have purchased extremely

* Prior to the hostilities, when nearly all Battambang rice moved by rail shipments during the three-month harvest season averaged 70 freight cars per day, each car carrying 20 tons of rice for a total of 1,400 tons per day.

** In normal times, transport costs for this trip averaged about 28 riels per bag by train and 30 to 35 riels per bag by truck.

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small amounts of rice for this time of year, perhaps because of the large stocks awaiting export in SONEXIM's Phnom Penh warehouses.

28. Because of the low price offered for paddy, farmers are storing record amounts of rice despite the risk of heavy losses. Although rice can be kept for three years or more if adequately protected from moisture and vermin, small farmers with poor storage facilities will probably lose large portions of their reserves. Merchants in Battambang are predicting that, because of the price squeeze, farmers will cut back on planting as they did this past year.*

Rice Exports

29. Rice exports in 1970 amounted to 200,000 tons and were valued at approximately \$18 million. Although this exceeds the 1969 total of 103,000 tons, valued at \$14.5 million, it was an extremely poor showing considering that the export of 450,000 tons had been projected before the outbreak of hostilities.

30. Prospects for rice exports in 1971 depend almost entirely on improvement in transport and security. There are still large surpluses in both Phnom Penh and Battambang. A recent attempt to move rice via the Mekong on six barges chartered from a Manila concern proved to be feasible but unprofitable. A shortage of trucks will be eased substantially by the arrival in early April of 600 US MAP-financed trucks from Australia. SONEXIM expects to get 150 of these trucks and plans to employ most of them in transporting rice. Insecurity on Route 4 and the Mekong, however, continues to be the principal constraint to increased rice exports.

31. The Cambodians are particularly concerned about fulfilling their commitments to Senegal, their principal customer by virtue of annual

* *There has been no reporting on the planting of dry-season crops, 80% of which are grown in the four provinces of Prey Veng, Kandal, Takeo, and Kompong Cham. Planting is usually finished by mid-March.*

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purchases in excess of 60,000 tons of low-quality broken rice in three of the past four years. At the end of the year, SONEXIM held in Phnom Penh more than 100,000 tons of rice grown expressly for the Senegalese.* Faced with severe transport problems and fearful of defaulting, the Cambodians in February arranged for the Thais to ship 10,300 tons of rice to Senegal on the Cambodians' account, according to a Thai press report. The Thai sale comes as a surprise, however, in view of the fact that Battambang warehouses are overflowing with surplus rice and an agreement concluded last fall authorizes the export of Battambang rice via Bangkok "in the event that Cambodia's own ports are inaccessible." Apparently, hopes that rice might move by this route have proved to be unrealistic.

32. The Cambodians, however, may already have lost most of the Senegalese market to the Thais, who, according to a Bangkok press report, have contracted for the sale of 80,000 to 100,000 tons of broken rice this year. Sales of this magnitude apparently would severely limit the Cambodians' chances, since Senegal's annual rice imports have averaged only about 160,000 tons in recent years and amounted to only 146,000 tons of rice in 1969, the last year for which annual statistics are available.

Petroleum Production and Supplies

33. Enemy mortar and rocket fire struck the storage area of the Kompong Som refinery on 2 March starting fires that destroyed or badly damaged eight tanks, comprising about three-fourths of storage capacity [redacted] The refinery itself was not hit [redacted]

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* Although a government monopoly over rice exports was abolished last October, SONEXIM remains the focal point of rice collection and export. Private traders have been unwilling to commit funds because of the high cost of shipping and insurance and the risk involved.

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34. The refinery must remain out of operation until much of the damage has been repaired. Cambodian officials estimate that a complete restoration would take six to eight months, at a cost of up to \$4 million. Their estimate appears to be high. All eight tanks can probably be replaced for about \$1.5 million, and reported damage to other equipment seems substantially less costly to repair. Furthermore, not all of the tanks need be replaced. The refinery has never been operated at more than two-thirds of its designed annual capacity, and operations over the past year have been on a considerably smaller scale. Limited but efficient operations could be resumed with only one of the crude oil tanks -- the three largest and most costly tanks destroyed or damaged -- and probably with fewer than the five diesel product tanks that were destroyed or damaged. The threat of additional attacks by strong enemy units that have operated in southwestern Cambodia for several months, however, may cause the Cambodians to postpone reconstruction until the security situation is substantially improved.

35. The shutdown of the refinery will have no significant or immediate effect on the flow of petroleum to Phnom Penh because the continued insecurity of Route 4 has prevented the trucking of more than a few hundred tons of petroleum from Kompong Som since the route was reopened in late January. The refinery had been shut down after the closure of Route 4 last November, and did not resume operations until February, after the initiation of a systematic transfer of petroleum products by tanker to Nha Be, South Vietnam.* These shipments were to replace products shipped up the Mekong to Phnom Penh under emergency arrangements with the South Vietnamese.

36. Loss of the refinery's output will put an added strain on Cambodia's limited foreign exchange reserves, however. Products now being imported from South Vietnam will have to be paid for in cash instead of being replaced by shipments

* No petroleum shipments to Phnom Penh via either Route 4 or Route 1 have been reported since mid-February.

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from Kompong Som. At the current rate of shipments of approximately 10,000 tons a month, these will cost on the order of \$300,000 a month (c.i.f. Saigon),* compared with estimated foreign exchange expenditures for crude oil of about \$170,000 per month to provide most of the same products from the refinery. There will be an additional loss of foreign exchange earnings from the export of surplus refinery products. Last year, with the refinery operating at considerably less than half of its capacity, Cambodia's petroleum export earnings totaled \$600,000.

37. Since late January, convoys have arrived in Phnom Penh with petroleum shipments at about 12-day intervals. In the first 60 days of operation of the heavily armed riverine convoys, nearly 22,000 tons of petroleum were delivered to Phnom Penh via the Mekong. These deliveries have been more than sufficient to cover the needs of FANK and essential civilian consumers, but stocks in Phnom Penh's central storage depots only occasionally exceeded a three-week supply, and those for some products at times became critically low when delivery schedules got out of step with consumption patterns. By 1 March, however, the situation apparently had improved enough to permit the lifting of petroleum rationing regulations that had been in effect since early December.**

38. Despite FANK efforts to improve security along the Mekong, travel on this vital route remains hazardous. As of mid-March, three of the last four convoys that included petroleum-carrying vessels either had been fired upon or encountered enemy mines. The heaviest recent attack occurred on 22 February, when enemy rocket and mortar fire exploded and destroyed one ammunition barge, inflicted heavy damage on one tugboat, and scored hits on a tanker and two freighters. On 16 March a tugboat towing petroleum barges was severely damaged when it struck a mine. The continuing insecurity of the river poses a serious threat to Phnom Penh's petroleum supplies: petroleum

* Shipping costs from Saigon to Phnom Penh are not included in this estimate.

** This statement is based on a press report and has not been verified by official sources.

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shipments up the Mekong are carried exclusively by foreign vessels whose owners and crews might at some point find the service too dangerous to be continued.

39. Petroleum consumers in Battambang are receiving adequate supplies from Thailand. In the three months since mid-December, Thai truckers delivered about 7,000 tons of assorted petroleum products from facilities near Bangkok. Deliveries included more than 400 tons of aviation gas, some of which was transferred in Cambodian trucks to Pochentong Airfield near Phnom Penh. In Kampot Province, insecurity along Routes 4 and 3 during the first two weeks of March disrupted petroleum deliveries from Kompong Som refinery, causing temporary shortages.

Imports

40. In Phnom Penh, prices of imported goods have increased nearly 50% since the turn of the year [redacted]

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[redacted] In outlying areas, imported goods are said to cost up to 40% more than in Phnom Penh. The only exception is the Battambang area, where foreign goods are cheaper than in Phnom Penh, thanks to a lively (but largely illegal) cross-border trade with Thailand.

41. The increasing scarcity of imported goods in 1970 was attributable largely to the government's efforts to conserve foreign exchange. Seaborne imports of goods other than petroleum and petroleum products declined steadily throughout 1970, as shown in the following tabulation:

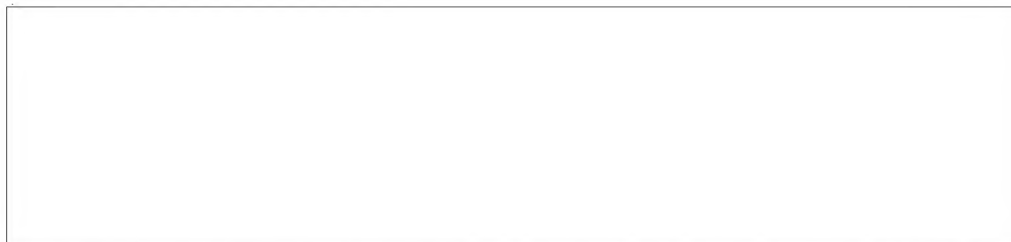
<u>Metric Tons</u>			
<u>Jan-Mar</u>	<u>Apr-Jun</u>	<u>Jul-Sep</u>	<u>Oct-Dec</u>
71,300	51,600	44,800	11,600

42. Since late November, interdiction of the main highways from Kompong Som has been a further constraint on imports. Only a few hundred tons of

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imports have been moved overland to Phnom Penh from Kompong Som.* The government is attempting to reduce its reliance on the highway by promoting greater use of the port at Phnom Penh. Consequently, 40 seagoing cargo ships** called at Phnom Penh in the three-month period of December-February, compared with only 42 in the preceding eight months. Many of the ships that arrived at Phnom Penh in December and January had been diverted from Kompong Som, and in January at least four ships brought in cargoes that previously had been offloaded at Kompong Som.

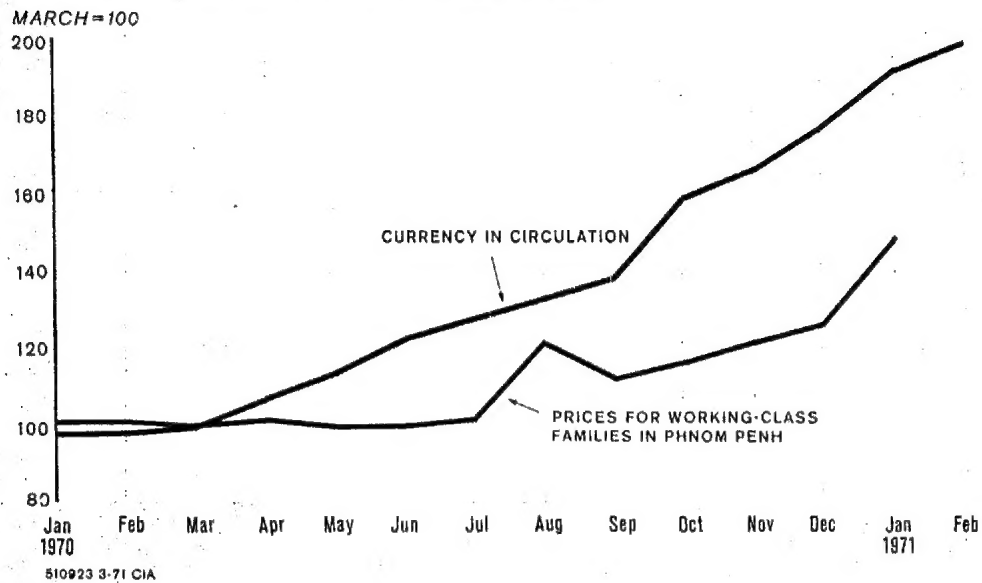
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*** These data exclude calls by barges and ships of less than 300 GRT.*

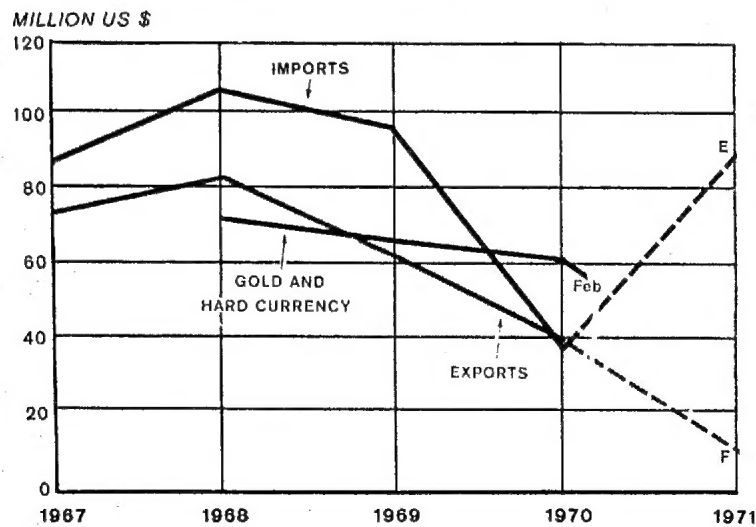
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CAMBODIA Indices of Currency and of Prices, 1970-71



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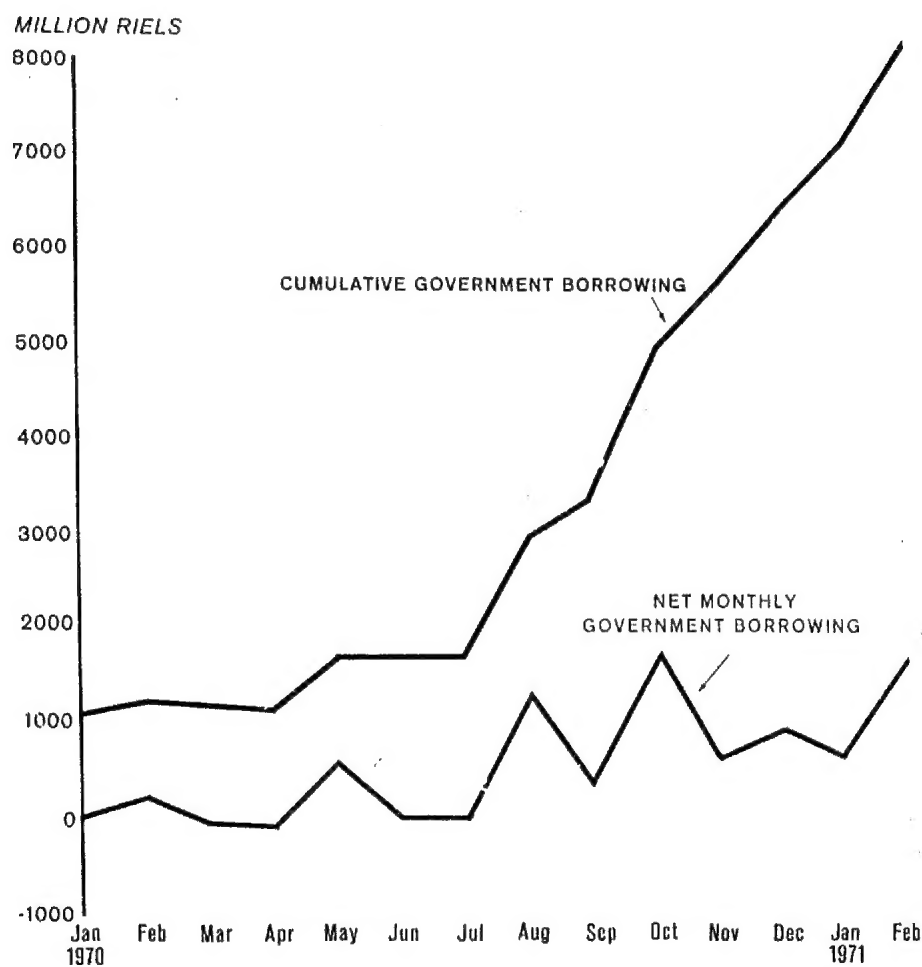
CAMBODIA Imports, Exports, and Gold and Hard Currency Holdings



E=Official projection explicitly based on prospect of foreign aid
F=Official revised projection

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CAMBODIA
Government Borrowing
from the Banque Nationale du Cambodge
1970-71



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